TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

July 16, 2009

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Texas Commission on Environmental Quality
Office of the Chief Clerk, MC-105
P.O. Box 13087
Austin, Texas 78711-3087

Re: Application of Double Diamond Utilities Co., Inc. to Change Its Water Rates and Tariff in Hill, Palo Pinto, and Johnson Counties, Texas, Application No. 35771-R; SOAH Docket No. 582-08-0698; TCEQ Docket No. 2007-1708-UCR

Dear Ms. Castañuela:

Please find enclosed the Executive Director's Reply to Exceptions to the Proposal for Decision. Please let me know if you have any questions.

Sincerely,

Stefanie Skogen

Stefanie Skogen
Staff Attorney
Environmental Law Division

Enclosure

cc: Mailing List

SOAH DOCKET NO. 582-08-0698
TCEQ DOCKET NO. 2007-1708-UCR

APPLICATION OF DOUBLE DIAMOND UTILITIES CO., INC. TO CHANGE ITS WATER RATES AND TARIFF IN HILL, PALO PINTO, AND JOHNSON COUNTIES, TEXAS, APPLICATION NO. 35771-R	§	**BEFORE THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**

EXECUTIVE DIRECTOR'S REPLY TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

The Executive Director (ED) of the Texas Commission on Environmental Quality (TCEQ or Commission), by and through a representative of the Commission's Environmental Law Division, files the following reply to exceptions to the Administrative Law Judge's (ALJ's) proposal for decision (PFD). In support of his reply, the ED shows the following:

I. INTRODUCTION

This reply responds to statements made by the other parties to this case in their exceptions to the PFD. To facilitate the discussion, each set of exceptions will be referred to individually, and any headings used refer to specific headings found in that particular set of exceptions. Although the ED's recommendation as detailed in his closing argument and exceptions has not changed, the ED offers the following based on the evidentiary record in this case to respond to arguments made by other parties.

II. REPLY TO THE WHITE BLUFF SUBDIVISION RATEPAYERS' EXCEPTIONS

On page 2 of the White Buff subdivision ratepayers' (WBSR's) exceptions, WBSR suggests four provisions to be added to the proposed order regarding Double Diamond Utilities' (DDU's) record keeping and future rate applications. Under section 13.131(a) of the Texas Water Code, the Commission can require any forms of books, accounts, and records "that in the judgment of the commission may be necessary to carry out [Chapter 13 of the Texas Water

Code]." In addition, "[e]very utility is required to keep and render its books, accounts, records, and memoranda accurately and faithfully in the manner and form prescribed by the commission and to comply with all directions of the regulatory authority relating to those books, accounts, records, and memoranda."[1] The ED believes that under these statutes, the Commission can adopt the first and third provisions proposed by WBSR if it wishes to do so. The second provision goes beyond being a mere record keeping requirement, as it would require DDU to "develop a reasonable methodology for allocating" expenses shared between the water and sewer systems. Therefore, if the Commission wishes to adopt this provision, the ED recommends revising it to read as follows: To the extent any expenses are shared among its water systems and/or its sewer systems, DDU shall maintain documentation demonstrating how such expenses are allocated between the systems and in what amounts.

With regard to the fourth provision proposed by WBSR, the ED does not believe the Commission can incorporate this provision into its final order. DDU has the right under title 30, section 291.21(m) to present evidence in its future rate cases to show that any systems it wishes to have consolidated under a single tariff are substantially similar. If DDU chooses to present such evidence, it makes sense that DDU would present one revenue requirement and one rate for the systems it wishes to consolidate. Ordering DDU to calculate three separate revenue requirements and rates would essentially prevent them from requesting consolidated rates in the future. Therefore, the ED recommends that the Commission not adopt the fourth provision.

III. REPLY TO DDU'S EXCEPTIONS

A. Multiple Systems Consolidated under One Tariff and Rate Design

The ED objects to the consideration of this section of DDU's exceptions. This is the first time that DDU has raised any argument regarding the consolidation of multiple water systems

[1] TEX. WATER CODE ANN. § 13.131(e) (Vernon 2008).

under one rate. The only reason the other parties and the ALJ have discussed this issue in their various filings is because DDU consolidated two of its water systems, White Bluff and The Retreat, under a single rate. DDU did not address the substantial similarity factors in its direct testimony, closing argument, or reply to closing arguments to show why it should be permitted to consolidate those two systems for rate purposes. The evidentiary record was closed in this case at the conclusion of the evidentiary hearing; DDU cannot provide any additional evidence on this issue at this time, and the Commission cannot consider it.[2] Not only are DDU's arguments untimely, but it also would be unfair to the parties and the ALJ to permit DDU to raise these arguments for the first time this late in the proceedings. DDU seems to have waited until filing its exceptions to make the majority of its arguments in this case, as its exceptions are three times longer than its closing argument. If DDU is permitted to provide this evidence and make these arguments at this time, the other parties and the ALJ are denied the opportunity to question any of DDU's witnesses regarding the additional evidence, present any evidence in response to DDU's evidence, and fully develop their responses to DDU's arguments.

If the Commission chooses to consider this section of DDU's exceptions, the ED continues to assert that DDU has not shown that White Bluff and The Retreat are substantially similar and, therefore, should have their own rates. DDU relies heavily on the PFD and final order in the recent Aqua Texas, Inc. rate case to support its position that its systems should be consolidated. However, the ED is not persuaded that the Aqua Texas case provides support for DDU's position based on the evidentiary record in this case. Whether to allow a utility to consolidate systems is evaluated on a case-by-case basis. The Commissioners had their reasons for allowing Aqua Texas to consolidate its systems; that does not automatically mean that

[2] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).

DDU's systems should be consolidated as well.

As cited to in the PFD, Aqua Texas presented evidence prior to the PFD to support its consolidated system structure.[3] As already noted above, DDU did not do the same in this case. The Aqua Texas case also involved two separate consolidation issues – regional tariffs and consolidating systems under a single tariff. Whether or not to allow a utility to regionalize its tariffs is considered by the Commission under section 13.182(d) of the Texas Water Code and title 30, section 291.21(n) of the Texas Administrative Code. Whether or not to allow a utility to consolidate systems under a single tariff is considered by the Commission under section 13.145 and section 291.21(m). In this case, only sections 13.145 and 291.21(m) apply. DDU wants to consolidate two of its systems under a single tariff; it is not attempting to establish regional tariffs. Therefore, any references that DDU makes to portions of the Aqua Texas PFD or order that discuss regional tariffs do not apply to this case.

DDU also points to the Aqua Texas case to show that systems should be compared to one another over time rather than considering them at a certain point in time, such as at the end of the test year.[4] While the ED may have considered that possibility in this case if DDU had presented any evidence regarding it, the point is that they did not provide any such evidence, and any attempt to do so now is outside the evidentiary record and cannot be considered by the Commission.[5] DDU's comparisons in Table 1 and the accompanying discussion of it is the first time this evidence has been presented and, therefore, must be disregarded.[6] Even if the Commission does choose to consider it, it does not demonstrate substantial similarity with regard to cost for service between the White Bluff and The Retreat's systems, either at the end of 2006

[3] PFD 23-45, TCEQ Docket Nos. 2004-1120-UCR and 2004-1671-UCR (July 5, 2007) [hereinafter Aqua Texas PFD].
[4] DDU's Exceptions to the ALJ's PFD 3-5 (July 3, 2009) [hereinafter DDU's Exceptions].
[5] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (stating findings of fact may only be based on the evidence).
[6] *See id.* (stating findings of fact may only be based on the evidence);.DDU's Exceptions 4-5.

or over time. All the table shows is that if you take the information presented by DDU for the end of the test year and look at it from two different perspectives, you get two different results. Furthermore, the table does not look at DDU's cost of service; it is comparing the original costs of the plants as presented in DDU's December 2007 "application."[7] The original cost of plant is not even one of the components of the cost of service.[8]

B. Developer Contributions and the Effect on Invested Capital

Just like the substantially similar issue, this is essentially the first time DDU has presented any evidence or argument regarding developer contributions. As DDU stated, DDU's application did list $0 in developer contributions, and the October 2008 application did list $1.9 million in developer contributions.[9] DDU also testified on cross examination that DDU "pays for 20% of the distribution and collection lines that go into the service territory of DDU" and that the developer contributes the remaining assets.[10] Beyond this, DDU did not provide any evidence or argument regarding developer contributions in its direct testimony, closing argument, or reply to closing arguments. The evidentiary record in this case is closed, so DDU cannot present any new evidence on this issue at this time. The ED also reasserts his arguments made in section III.A above regarding untimeliness and unfairness to the parties and concludes that the Commission cannot consider DDU's evidence and arguments regarding developer contributions presented in its exceptions.[11]

To the extent that the Commission does consider this evidence and arguments, the ED does not find DDU's argument persuasive. DDU claims that Table IV.E of the application lists

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[7] Ex. APP-25, at 32, 35.
[8] *See* Ex. ED-1 att. U at 28 (listing the cost of service components at lines A-K and M-Q).
[9] DDU's Exceptions at 7.
[10] Transcript of Hearing 42:9-17 (Feb. 23-24, 2009).
[11] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).

$0 in developer contributions because DDU did not include any developer contributions in its depreciation schedule.[12] However, DDU has never provided any information regarding exactly how any developer contributions for each asset were removed from the depreciation schedule. If nothing else, the parties would need the opportunity to question DDU's witnesses regarding DDU's assertion and conduct further investigations to determine if all the developer contributions were in fact excluded from the application. According to DDU, "[t]he ED states that because $1.9 million in developer contributions is included in DDU's October 2008 application, this proves that DDU has failed to removed developer contributions in the current proceeding."[13] However, what the ED actually stated, and which the ALJ also stated in the PFD, is that "in this case, DDU has possibly included items in its rate base that were paid for with developer contributions."[14] In other words, this issue is unclear, and it remains unclear to this day.

DDU presents a comparison table to support its argument via Table 2,[15] but just as with Table 1, DDU has not presented this comparison previously and, therefore, it is evidence outside the evidentiary record that cannot be considered by the Commission.[16] If nothing else, the table contains information from page 10 of DDU's October 2008 application,[17] but this page is not in the evidentiary record and, therefore, cannot be considered by the Commission.[18] If the Commission chooses to consider Table 2, the net book value listed in the application is $1.8

[12] DDU's Exceptions at 7.
[13] *Id.* at 8 (citing PFD 24, TCEQ Docket No. 2007-1708-UCR (June 15, 2009) [hereinafter PFD]).
[14] PFD at 24 (citing ED's Closing Argument 14 (Mar. 31, 2009)).
[15] DDU's Exceptions at 8.
[16] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).
[17] DDU Exceptions at 8 n. 28.
[18] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (stating findings of fact may only be based on the evidence); ex. ED-4 (containing only the cover page, pages 1 and 11, and attachment 6 from the October 2008 application); ex. WBSR-24 (containing only the cover page and page 11 from the October 2008 application).

million,[19] and it is unclear where the additional depreciation of $200,000 comes from, as the footnote only refers to the October 2008 application. Therefore, the difference between the net book values in the two applications could be as much as $400,000, and this does not even take into account the deductions made by the ED in his analysis in this case. The difference may be due to an additional year of depreciation, but there also could have been new assets installed during that year. Essentially, an apples-to-apples comparison cannot be done based simply on the information contained in Table 2.

While it may be that DDU did remove developer contributions from its application in this case, the point remains that DDU failed to raise this issue on its own prior to the filing of its exceptions to the PFD. Unfortunately, this is too little too late, and DDU's exceptions on this subject should not be considered by the Commission or at a minimum should not be found to be persuasive.

C. Rate of Return/Return on Invested Capital

1. Calculation of Separate Rates of Return for Each Resort

DDU points to the Aqua Texas case to provide support for its argument that it should have one weighted average rate of return (ROR).[20] However, just as with the determination of whether a utility should be permitted to consolidate systems under a single tariff, the issue of what a utility's weighted average ROR should be is considered on a case-by-case basis. The Commission had its reasons to calculate one weighted average ROR in the Aqua Texas case, but that does not automatically mean that every utility with multiple systems should have one weighted average ROR. In this case, the ED determined that White Bluff and The Retreat should

[19] Ex. ED-1 att. U at 17.
[20] DDU's Exceptions at 9.

not be consolidated and calculated separate rates for each system.[21] Because the ED calculated three different rates, he believed it was appropriate to calculate three different weighted average RORs.

The fact that the weighted average RORs ended up being so different provides support for the ED's decision. For example, The Retreat had an ROR of 10.48% versus 8.48% for The Cliffs and White Bluff.[22] If the ED had grouped the three systems together, the overall ROR would have been 8.48% because the total number of connections would have exceeded 200, an amount which The Retreat's connection count fell under and allowed it to receive two extra percentage points.[23] Additional support comes from the ED's calculation of a negative equity amount for The Cliffs and White Bluff.[24] If the ED had calculated one weighted average ROR, then whatever business decisions that led to those two systems having a negative equity would have essentially been supported by The Retreat's positive equity.[25] DDU appeared to find the ED's method acceptable until now, as it did not argue against it in its closing argument or reply to closing argument, nor did they ask Ms. Elsie Pascua, TCEQ auditor and expert witness in this case, any questions about it during the evidentiary hearing.

2. Cost of Debt

As the ED stated in his closing argument, DDU's loan came from its parent company, Double Diamond-Delaware, Inc. (DD-DI).[26] As DDU's parent company, DD-DI profits from any income DDU earns.[27] Furthermore, as a large business entity, a parent company should be able to obtain a favorable interest rate on its own loans, i.e. one that is lower than 10%. The ED

[21] Ex. ED-1, at 4:13-15; ex. ED-2, at 12:17-23, 13:7-13, 13:20-14:3.
[22] Ex. ED-1 att. R at 2, 4, 6.
[23] *Id.* att. R at 1.
[24] *Id.* att. G, K.
[25] *Id.* att. C.
[26] ED's Closing Argument 19, 25, 31 (Mar. 31, 2009).
[27] *Id.* at 19, 25, 32.

found the interest rate of 10% excessive under these circumstances and reduced it to 4.87%.[28] DDU did not question ED staff regarding this adjustment at the evidentiary hearing, did not present any rebuttal testimony to challenge it, nor argued against it in DDU's closing argument or reply to closing argument. WBSR actually argued that the rate should be reduced to 0%, but the ED defended allowing DDU an interest rate of 4.87% to enable DDU to collect more money through its rates to pay back its loan than an interest rate of 0% would provide.[29] Therefore, the ED asserts that his adjustment was appropriate.

3. Return on Equity

DDU believes that because the Commission has granted other utilities a 12% ROR in past cases that DDU is also entitled to a 12% ROR.[30] At the risk of sounding like a broken record, ROR is considered on a case-by-case basis. The Commission had its reasons for granting an ROR of 12% to Aqua Texas and in other past cases, but that does not automatically mean that DDU should also be granted a 12% ROR. DDU did not point to any specific characteristics that it possesses that show that it should receive an ROR above those recommended by the ED. The ED believes that the ROR worksheet revealed that DDU was not entitled to a 12% ROR.

The ED used the ROR worksheet to calculate the ROR for each individual system. As the ED stated in his closing argument, "The TCEQ has developed an ROR worksheet that incorporates the principles found in section 291.31(c)(1)(A)-(C) and facilitates the calculation of the ROR."[31] In other words, the ED can use the worksheet to tailor the ROR to reflect the specific characteristics of a water or sewer system and the utility that operates it as well as

[28] *Id.* at 19, 25-26, 32.
[29] ED's Reply to Closing Arguments 4 (Apr. 14, 2009).
[30] DDU's Exceptions 11-12 (July 3, 2009).
[31] ED's Closing Argument at 13.

incorporate the state of the public utility market via the current Baa public utility bond average.[32] As the ED already discussed above, using the worksheet resulted in an ROR of 8.48% for The Cliffs and White Bluff and 10.48% for The Retreat.[33] The ED believes he was generous in his ROR calculations and stands behind his calculations of an ROR of less than 12% for all three systems, calculations which the ALJ supported.[34]

4. Calculation of Weighted Average Return

The ED's calculation of the weighted average return is just that – a calculation. The weighted average RORs for The Cliffs and White Bluff are lower than the debt interest rate because the numbers that went into their calculations made them that way, not because the ED intended to make those RORs lower than the interest rate. As DDU states in its exceptions, because DDU had debt that exceeded its invested capital at The Cliffs and White Bluff, those two systems have negative equity.[35] DDU's invested capital was so low at least in part because the ED had to make deductions due to a lack of supporting documentation for DDU's costs and expenses and allocate some costs and expenses between the water and sewer systems as well as the three subdivisions, all of which was discussed ad nauseam in the ED's prefiled testimony, closing argument, and reply to the closing argument and the PFD.[36] The negative equity could have also resulted from a lack of investment in the systems' capital assets, other unfortunate business decisions, or any developer contributions that were accounted for in the application.

DDU asserts that allowing a utility a weighted average ROR lower than its cost of debt is "unconscionable for a utility that has already demonstrated for the record that is has been

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[32] *See* Ex. ED-1 att. R (showing what factors and calculations incorporate the worksheet).
[33] Ex. ED-1 att. R at 2, 4, 6; *see supra* section III.C.1.
[34] PFD 49 (June 15, 2009).
[35] Ex. ED-1 atts. G, K; DDU's Exceptions 12 (July 3, 2009).
[36] Ex. ED-1, at 5:2-15, 8:18-15:26; ex. ED-2, at 6:14-11:4; ED's Closing Argument 9-12, 15-32 (Mar. 31, 2009); ED's Reply to Closing Arguments 7-10 (Apr. 14, 2009); PFD at 31-90.

operating at a loss for the last several years."[37] However, the ALJ did not state that DDU had made such a demonstration; the PFD merely states DDU presented evidence regarding its operation losses.[38] In fact, the PFD goes on to state that DDU did not distinguish between water and sewer system losses in its evidence.[39] The bottom line is that if DDU had provided sufficient support for its application, its weight average RORs for The Cliffs and White Bluff may have exceeded the loan interest rate..

D. Operation and Maintenance Expenses

1. Salary or Contract Services/Payroll Taxes

DDU argues that some of its expenses should be allocated 77.6% to its water systems.[40] However, DDU's use of a 77.6% allocation is evidence not in the record and, therefore, cannot be considered by the Commission.[41] This is the first time the parties have been presented with this percentage, as DDU did not provide it or discuss it prior to filing its exceptions. DDU asserts that Charles Gillespie, Jr., one of DDU's witnesses, testified regarding this methodology at this hearing.[42] Mr. Gillespie may have discussed using an allocation based on the ratio between water and sewer billings, but he never stated that he did a 77.6/22.4 allocation, demonstrate exactly how those percentages were calculated, nor presented any physical evidence showing why conducting the allocation in that manner was appropriate. In fact, when he was asked what the percentage was, he said he did not recall.[43] Therefore, the ED contends that DDU's discussion of the 77.6% allocation must be disregarded. Not only is it untimely, but it is unfair to the other parties and the ALJ to consider this information at this time, as the evidentiary record has been

[37] DDU's Exceptions at 13 (citing PFD at 92).
[38] PFD at 92.
[39] *Id.*
[40] DDU's Exceptions at 14-15, 17-18.
[41] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).
[42] DDU's Exceptions at 14 (citing Transcript of Hearing 97:5-12 (Feb. 23-24, 2009)).
[43] Transcript of Hearing at 102:11-16.

closed and there are no further opportunities to take evidence on this issue.

To the extent that the Commission does consider this argument, the ED argues that there is not enough evidence regarding the 77.6% allocation to determine if its use is appropriate in this case. There is nothing in the evidentiary record showing how closely DDU's water and sewer rates relate to its actual costs and expenses, so there is no way to know if DDU's revenues are a direct reflection of its costs.[44] It also appears that the sewer rate at least as of July 11, 2007, is a flat rate, which means there is no gallonage charge to account for variable expenses.[45] The ED has also already demonstrated in his closing argument that whether any allocations were done in the application is in question.[46] For example, before making adjustments, Ms. Pascua's total for salaries and wages based on DDU's W-2s was $270,077.[47] The application lists salaries and wages in the amount of $272,369.[48] If DDU had allocated salaries and wages between the water and sewer systems, then the amount in the application should have been lower than what was in the W-2s, not higher. DDU now wants the Commission to use its statement of operations if the Commission finds the salaries and wages amount in the application unacceptable,[49] an application submitted by DDU as a statement of its costs and expenses in support of its requested rates and which DDU has the burden of proving up.[50] The ED based his analysis on the information submitted by DDU. His analysis should stand as the correct one.

DDU's reference to the instructions to the application[51] also cannot be considered by the

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[44] *Id.* at 104:14-16.
[45] Ex. ED-5, at 78.
[46] ED's Closing Argument 12 (Mar. 31, 2009).
[47] Ex. ED-1 att. P.
[48] *Id.* att. U at 28.
[49] DDU's Exceptions 14 (July 3, 2009).
[50] 30 TEX. ADMIN. CODE § 291.12 (West 2009).
[51] DDU's Exceptions at 14 n. 54.

Commission, as those instructions are not in the evidentiary record in this case.[52] Therefore, the ED asserts that any statement made in relation to those instructions must be disregarded.

2. Chemicals

The ED reasserts his two-paragraph argument against the consideration of and application of the 77.6% allocation cited by DDU in its exceptions, as detailed in section III.D.1 above, with regard to DDU's chemical expenses.

3. Repairs/Maintenance/Supplies

DDU argues that the ALJ failed to address the specific points raised by DDU regarding its repairs/maintenance/supplies expenses in its closing argument.[53] However, the ALJ did address DDU's arguments when she stated, "DDU did not respond with citations to the record that demonstrated support for the expenses claimed in its application. Instead of addressing the specifics of the parties' concerns, DDU attempted to show the alleged magnitude of the deductions. DDU simply left the specific issues unaddressed."[54] She then gives DDU's argument regarding the Toray membranes as an example.[55]

The utility also takes issue with the ED's analysis of its expenses, stating there appears to be "a presumption of deceit" on the ED's part.[56] The ED has defended his analysis of DDU's expenses time and again throughout this case and will continue to do so here. Unfortunately for DDU, the ED is not the now-defunct accounting firm of Arthur Andersen. ED staff takes its auditing of a utility's books during a rate proceeding seriously and needs to receive sufficient documentation, usually in the form of an invoice, to support the utility's claimed expenses.

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[52] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).
[53] DDU's Exceptions at 15.
[54] PFD 72 (June 15, 2009).
[55] *Id.*
[56] DDU's Exceptions at 15.

While a general ledger is a useful bookkeeping tool, the ED needs to see sufficient supporting documentation for the expenses listed therein to verify what they were for, the amount they cost, whether they were for the water and/or sewer system, that they were categorized properly, etc. The ED needs this documentation not only to protect a utility's customers from paying for expenses they should not pay for but also to ensure the utility is recouping its expenses that should be billed to the customers and maintaining its financial stability. Ultimately, the ED must confirm that the utility's allowable expenses are reasonable and necessary.[57]

With regard to the specific items which DDU claims the ED and ALJ should not have disallowed, the ED disallowed the $12,046 for Toray membranes and $11,158 for a Shelco filter housing for The Cliffs and $3,550 for an electrical bid for ratio control for front wells for White Bluff because he could not determine from their invoices whether they were expenses or assets, i.e. whether they had been categorized properly.[58] DDU could have provided clarification regarding these invoices during its rebuttal testimony but chose not to do so. Therefore, the ED continues to recommend exclusion of these items. As the ED discussed in his reply to closing arguments, he did not disallow the $14,582 listed as a White Bluff expense for "Pull & Inspect, Motor, Pipe, Etc."[59]

DDU again tries to argue that an allocation of 77.6% should be applied to its statement of operations to calculate its repairs/maintenance/supplies expenses. The ED again reasserts his two-paragraph argument against the consideration of and application of the 77.6% allocation cited by DDU in its exceptions, as detailed in section III.D.1 above, with regard to DDU's repairs/maintenance/supplies expenses.

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[57] 30 TEX. ADMIN. CODE § 291.31(b) (West 2009).
[58] Ex. ED-1, at 11:26-12:2, 14:14-16, atts. N, O, V. at 1-4.
[59] ED's Reply to Closing Arguments 9 (Mar. 31, 2009) (citing Closing Statement of Applicant Double Diamond Utils. Co. 4 (Mar. 31, 2009) [hereinafter DDU's Closing Argument]; ex. ED-1 att. T at 67; ex. ED-1 att O).

4. Rate Case Expense

The ED continues to recommend that DDU's application be denied, meaning DDU cannot recover any of its rate case expenses from its customers according to title 30, section 291.28(8) of the Texas Administrative Code. Even if the Commission does find that DDU is entitled to recover its rate case expenses, the ED has already analyzed DDU's rate cases expenses listed in its general ledgers and made deductions based on that analysis.[60] With those deductions, the ED recommends granting DDU $1,067 in rate case expenses for each system, for a total of $3,201. If the Commission believes DDU is entitled to additional rate case expenses incurred since the filing of the ED's prefiled testimony, then it would need to take additional evidence on that issue.

5. Payroll Taxes

DDU contends that the ALJ and the ED recommend that DDU recover nothing for payroll expenses.[61] However, this is not the case; the ED merely included payroll taxes and the rest of the payroll burden in the amounts he listed for the salaries and wages expenses.[62]

Because DDU again asks the Commission to apply the 77.6% allocation to its statement of operations,[63] the ED reasserts his two-paragraph argument against the consideration of and application of the 77.6% allocation cited by DDU in its exceptions, as detailed in section III.D.1 above, with regard to DDU's payroll taxes.

6. Federal Income Taxes

Because the ED supports his calculations for DDU's return, invested capital, and weighted average rate of return, he continues to recommend that the Commission adopt his

[60] Ex. ED-1, at 10:6-8, 12:17-21, 14:26-15:5.
[61] DDU's Exceptions 18 (July 3, 2009).
[62] PFD 81-82 (June 15, 2009); ED's Closing Argument 15, 21, 28 (Mar. 31, 2009) (citing ex. ED-1 atts. B, F, J, P).
[63] DDU's Exceptions at 18.

calculation of the federal income taxes for each of the three systems.

7. Annual Depreciation and Amortization

DDU expresses displeasure with the ED's analysis of its costs in this section because the ED disallowed some of those costs due to a lack of sufficient supporting documentation.[64] Just as with the expenses, the ED has a responsibility to examine the amounts claimed for DDU's assets and verifying those costs via sufficient supporting documentation. For each asset, the ED must verify what the asset is, what it is used for, the fact that it exists, the fact that it is used and useful, how much the asset cost, whether it was categorized properly, etc. For the ED to conduct this analysis, the utility must provide the ED with sufficient supporting documentation, usually in the form of an invoice. ED staff asked for this documentation repeatedly throughout the course of this case for both DDU's costs and expenses[65] but never received all the information they requested. The only explanation ever provided to the ED as to why DDU was not providing the requested invoices was in DDU's responses to the ED's discovery, in which DDU objected to the ED's request for invoices for the repairs/maintenance/supplies expenses "because it is overly burdensome to retrieve these invoices from archive storage" or simply because it was "overly burdensome."[66] If a utility does not provide sufficient supporting documentation for its application, the ED must adjust his calculations of his recommended rates accordingly.

a. The Retreat

DDU states it was not able to locate invoices related to the well installed in December 2003.[67] However, this claim is not in the evidentiary record, and as that record is closed, the

[64] *Id.* at 18-22.
[65] *E.g.*, ex. ED-3 (ED's discovery to DDU with DDU's responses); ex. ED-2 att. H (Mr. Dickey's request for information); Transcript of Hearing 206 (Feb. 23-24, 2009) (testimony regarding Ms. Pascua's request for invoices at the audit).
[66] Ex. ED-3, at 5 (response to Interrogatory No. 9), 8 (response to Request for Production No. 18).
[67] DDU's Exceptions at 19.

Commission cannot consider this evidence.[68] If the Commission does choose to consider this information, then the ED wonders why DDU cannot locate the invoices for a well that was installed less than six years ago. Furthermore, the documentation DDU refers to in exhibits APP-23 and 26 are just general ledgers and a list of asset additions, respectively. The fact that DDU did not provide any other supporting documentation, such as invoices, is why the ED disallowed the well.[69] There are also several issues with the general ledgers provided in exhibit APP-23. The cover sheet states that $228,191 was for a well but that $140,601 was for plant.[70] Even if you assume that the entire $368,792 was for a well, the general ledgers do not demonstrate how the $98,363 was calculated. Twenty percent of $368,793 is $73,758, not $98,363. Adding up the 20% notations listed on the individual general ledgers also equals $73,758.[71] This is one of many examples of how the amounts in DDU's general ledgers do not match up with the amounts listed in its application.[72] The ED asserts that DDU did not provide sufficient documentation for this asset and continues to recommend that it be disallowed.

The ED also recommends that the well pump amounts be excluded, as he excluded both due to a lack of sufficient supporting documentation.[73] Just because a well pump may exist does not show how much it cost and whether the costs associated with it were categorized properly.

b. White Bluff

With regard to three of its wells at White Bluff, DDU states it was unable to locate invoices for these wells and that Mr. Gillespie used a deflationary scale to calculate their values.

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[68] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).
[69] Ex. ED-2, at 8:6-9, att. C.
[70] Ex. APP-23, at 1.
[71] *Id.* at 2-8.
[72] *See* ED's Closing Argument 10-11 (Mar. 31, 2009) (discussing how the general ledgers did not support the application and how Ms. Pascua had to base her calculations off the general ledgers rather than the application because of it).
[73] Ex. ED-2, at 8:6-9, att. C.

However, none of this information is in the evidentiary record, and as that record is closed, the Commission cannot consider this evidence.[74]

To the extent that the Commission chooses to consider this information, the record would need to be reopened to give the parties an opportunity to examine this information, question Mr. Gillespie regarding it, and compile and present any evidence that may be contrary to DDU's evidence. DDU has not provided any information regarding the source of the deflation factors and whether it is appropriate to use the cost of Well #4 as a starting point, such as whether all the wells were constructed in the same manner. A look at the driller's logs for the wells may be necessary to make this determination. As the record stands today, the ED excluded these items due to a lack of sufficient supporting documentation and recommends that they still be excluded.[75]

As for DDU's objection to the exclusion of a $96,240 water tank,[76] the following is the ED's discussion of this exclusion from the ED's reply to closing arguments:

> According to its closing argument, DDU believes the ED was unjustified in disallowing depreciation for a ground storage tank at White Bluff in the amount of $98,182.[77] DDU's depreciation schedule found in exhibit APP-12 lists the tank as "White Bluff water system storage tank," acquired in September 2001 for the amount of $98,182.[78] The depreciation schedule in the application just lists the item as a storage tank, acquired on June 1, 1999, for the amount of $96,240.[79] The general ledger in exhibit APP-16 lists the tank as "Water System Storage Tank

[74] *See* TEX. GOV'T CODE ANN. § 2001.141(c) (Vernon 2008) (stating findings of fact may only be based on the evidence).
[75] Ex. ED-2, at 7:3-7, att. B.
[76] DDU's Exceptions 20-21 (July 3, 2009).
[77] DDU's Closing Argument 3 (Mar. 31, 2009).
[78] Ex. APP-12, at 1.
[79] Ex. ED-1 att. U at 23.

Y2000," acquired in 2000 for a total of $98,182.[80] Comparing the general ledger and the depreciation schedule in the application, the two documents list different prices and different installation dates. How was the ED supposed to know that these two sets of documents were for the same item? The general ledgers and accompanying documentation could have been for a completely different storage tank, such as for a tank for a golf course irrigation system. According to DDU, ED staff needed to seek out DDU's second depreciation schedule, which listed yet a third installation date for the tank, the general ledgers and accompanying documentation, and the depreciation schedule in the application so staff could conclude that the three sets of conflicting information were all talking about the same item. The burden is on DDU to provide supporting documentation for its application; it is not the ED's burden to engage in a guessing game with regard to the information provided. An applicant needs to ensure that its application accurately reflects its records. When it has failed to do this, the utility should not be surprised when an asset is disallowed due to a lack of supporting documentation.[81]

As for the ED's exclusion of the item referred to as "Structures" by DDU in the amount of $8,882,[82] the following is the ED's discussion of that exclusion from his reply to closing arguments:

DDU asserts that the amount of $8,883 for "Structures" should have been allowed in the depreciation schedule, citing to the supporting documentation that DDU

[80] Ex. APP-16, at 1-2.
[81] ED's Reply to Closing Arguments 7-8 (Apr. 14, 2009).
[82] DDU's Exceptions 21-22 (July 3, 2009).

provided.[83] As Mr. Dickey stated in his testimony, he disallowed the cost because DDU did not provide an invoice showing what "structures" refers to and that those "structures" were used for the water system.[84] Looking at the documentation that DDU did provide, the general ledger states the cost was for "Engineering Wtr system."[85] The accounts payable coding form lists the cost as "Engineering Wte System" and "Engineering – Water System Improvements at W.B."[86] Other than the fact that this cost was incurred for some sort of engineering for the water system, these documents do not describe what exactly DDU paid the $8,823 [sic] for. Assuming that this amount was paid for an asset, ED staff cannot identify the asset, verify its existence, and determine if it is used and useful[87] when they have been provided with essentially no description of what that asset is. Therefore, the ED had to disallow this amount in the depreciation schedule.[88]

8. Financial Integrity

DDU claims the utility as a whole has been operating at a loss for several years. However, as the ED stated above, the ALJ did not make a finding that DDU has in fact been operating at such a loss.[89] DDU believes there has been a complete disregard of its financial well-being in this case,[90] but that statement could be turned around to say that DDU has shown a complete disregard for its own financial well-being and for the provision of continuous and adequate service to its customers by not adequately supporting its application if a rate increase is

[83] DDU's Closing Argument 4 (Mar. 31, 2009).
[84] Ex. ED-2, at 6:19-23.
[85] Ex. APP-14, at 1.
[86] *Id.* at 4.
[87] Under section 291.31(b)(1)(A), depreciation on an asset is computed over the "useful" life of the asset and is allowed on a "used" asset.
[88] ED's Reply to Closing Arguments 8-9 (Apr. 14, 2009).
[89] *See supra* notes 37-39 and accompanying text.
[90] DDU's Exceptions 22 (July 3, 2009).

in fact needed to keep the systems operating. The ED believes that allowing DDU to revert back to its current rates, i.e. the rates charged before the proposed rates in this case, as opposed to lowering the rates below those current rates as WBSR recommended, assists DDU with maintaining its financial integrity.[91]

9. Refund

DDU argues that if the Commission orders it to pay its customers any credits or refunds that no interest should added to those credits or refunds. However, the Commission is required by law to "refund or credit against future bills all sums collected in excess of the rate finally ordered *plus interest*."[92] Therefore, the Commission has no choice but to add interest to any credits or refunds it orders DDU to pay.

IV. CONCLUSION

DDU filed an application to amend its rates for three water systems. The ED analyzed that application based on the information provided by DDU and the laws of the State of Texas. Based on his analysis, the ED calculated rates that are below DDU's current rates and, therefore, recommended that DDU's application be denied. DDU did not show that The Retreat and White Bluff systems are substantially similar, did not show how it calculated its proposed rates based on its revenue requirement, and did not provide sufficient supporting documentation for all the costs and expenses listed in its application. Therefore, the ED again requests that the Commission adopt the ALJ's proposed order with the ED's recommended changes presented in his exceptions to the PFD.

[91] WBSR's Closing Argument 34 (Mar. 31, 2009); *see also* ED's Reply to Closing Arguments at 7 (discussing the risks of lowering DDU's rates below its current rates).
[92] 30 TEX. ADMIN. CODE § 291.29(h) (West 2009) (emphasis added).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on July 16, 2009, a copy of the foregoing document was sent by first class, agency mail, electronic mail, and/or facsimile to the persons on the attached Mailing List.

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